

DOCKET SECTION

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D. C. 20268-0001

RECEIVED  
April 18 1998

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

INITIAL BRIEF  
OF THE  
SATURATION MAIL COALITION

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April 1, 1998

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Docket No. R97-1

**INITIAL BRIEF OF THE SATURATION MAIL COALITION**

The Saturation Mail Coalition hereby submits this Initial Brief to the Commission in this proceeding.

**STATEMENT OF POSITION**

It is the position of the Saturation Mail Coalition that:

- The Postal Service's overall proposed rates and revenue requirement are consistent with the strategically sound objectives of maintaining moderate rate increases below the rate of inflation while insuring financial stability of the nation's postal system.
- The Postal Service's proposed rates for Standard A Enhanced Carrier Route (ECR) mail are reasonable, prudent, and satisfy the statutory criteria of the Act.
  - Reasonable and affordable rates for ECR saturation mail produce important benefits to mail users (particularly small businesses), consumers, and the economy, and preserve viable and beneficial competition.
  - Absent reasonable, cost-based rates, saturation mail and the valuable contribution it provides to institutional costs would be at risk, to the detriment of mail users and the postal system.
- The Postal Service's proposed rate levels and rate structure for the ECR subclass are reasonable and well supported.
  - The moderate reduction in the excessive ECR pound rate still over-charges pound-rated mail in relation to weight-related costs, but is a needed step in the right direction.
  - Equalization of the letter/flat rates for basic-level ECR mail is consistent with the sound strategic plan to maximize Delivery Point Sequenced volume.

- The letter/flat rate differentials for high density and saturation ECR mail are cost-based and reasonable (but high because of their interrelationship with the pound rate).
- The discounts for high density and saturation mail are cost-based and reasonable.
- The Postal Service's treatments of city delivery carrier load time and rural carrier costs are flawed and substantially overstate ECR attributable costs.<sup>1</sup>

## **INTRODUCTION AND SUMMARY OF ARGUMENT**

The Saturation Mail Coalition (SMC) intervened in this proceeding to support the rates proposed by the Postal Service for the Enhanced Carrier Route (ECR) subclass and the proposed changes in rate structure. The Postal Service's proposal, if recommended by the Postal Rate Commission, will establish postal rates that are more cost-based, and that will reflect the greater price sensitivity of saturation mail and the competitive realities of the marketplace for advertising materials.

Docket R97-1 is unique in the history of rate proceedings before the Postal Rate Commission. This is the first proceeding in which the Postal Service proposed moderate rate increases for all classes and subclasses of mail, consistent with its and the Governors' change of pricing policy, i.e., to request smaller, more manageable, more predictable rate increases that are below the cumulative increase in the Consumer Price Index. This is also the first general rate proceeding since Docket R94-1 in which the Postal Service and the Governors could respond directly to the Commission's criticisms concerning the timing of rate case filings, the amount of requested rate increases, and the failure of the Postal Service to restore its equity position. The Postal Service and the Governors have responded in a manner that specifically addresses

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<sup>1</sup> These two costing issues are addressed in the Joint Initial Brief of Advertising Mail Marketing Association, Direct Marketing Association, Mail Order Association of America, Parcel Shippers Association, and Advo, Inc. Concerning City Delivery Carrier Load Time Costs and Rural Carrier Costs.

these criticisms. The Postal Service filing is also responsive to the pleas of its customers, who have been adversely affected by the old policy of large rate increases.

The Postal Service's sound and prudent pricing objective to develop rates that more closely reflect its costs, the price sensitivities of its various product lines, and the competition that it faces in virtually all classes of mail -- in order to enable it to meet its universal service obligations to the American public -- is the essence of its filing.

One of the primary beneficiaries of this focus is the ordinary user of First Class unsorted mail. In addition to seeking only a one cent increase in the First Class rate, the Postal Service's filing concentrates on trying to preserve the revenue contributions received from subclasses subject to competition in the private sector. Loss of volumes and revenues in these subclasses would only increase the burden on the First Class mail user. More significantly, it would jeopardize the ability of the Postal Service to continue to meet the universal service demands and needs of First Class mail.

One element of this focus is the Postal Service's renewal of the request it first made in the Docket MC95-1 classification proceeding for a lower pound rate for the ECR subclass. The Commission recommended the ECR subclass in that proceeding, but without the lower pound rate. In their decision the Governors specifically noted that "the historic level of the pound rate ... cannot continue to be justified for Enhanced Carrier Route...." The Governors stated further:

"In this competitive area, as the evidence of record makes clear, alternative providers do not use price structures that depend so heavily on a pound charge, and it is imperative that these facts not be ignored in setting prices for the Postal Service's product." BOG Decision at 9.

The Postal Service testimony, buttressed by the testimony of SMC witness Buckel, AISOP witness Otuteye, and Advo rebuttal witness Crowder, make an even more compelling case for a lower pound rate.

## ARGUMENT

### I. SATURATION MAIL MAKES A MAJOR CONTRIBUTION TO INSTITUTIONAL COSTS AND PROVIDES A VALUABLE SERVICE TO SMALL BUSINESSES AND CONSUMERS.

#### A. Saturation Mail's Contribution to Institutional Costs.

ECR saturation mail is an important but vulnerable segment of the postal mailstream. Even as a rate category within the Bulk Rate Regular subclass before reclassification, carrier route mail had one of the highest implicit institutional cost coverages of any mail category and generated a high unit contribution to institutional costs. Although one of the reclassification objectives in establishing ECR mail as a separate subclass was better recognition of the high price sensitivity of this mail in setting rates, ECR mail continues to have one of the highest institutional cost coverages of any subclass and a high unit contribution. At the Postal Service's proposed rates, ECR mail will make an average contribution of 8.3¢ per piece with a cost coverage of 226 percent. USPS-15J. This is still substantially higher than that for the Standard A Regular subclass (a 7.4¢ unit contribution and 154 percent cost coverage). Id.

These figures for ECR, based on the Postal Service's estimated costs and revenues, actually understate the true contribution at the proposed rates. First, the costs attributed to ECR are overstated in several respects (see Joint Initial Brief of AMMA, et al., referenced at n. 1). Second, the Postal Service's projected ECR revenues clearly understate the incremental pound-rate revenues that will be generated by its proposed lower ECR pound rate (infra at 44).

The unit contribution from the saturation mail component of ECR is likewise higher than the ECR subclass average. As shown by Advo witness Crowder, both the unit contributions and implicit cost coverages of drop shipped saturation mail significantly exceed those of basic-level non-drop shipped mail, both for lighter-weight and heavier weight pieces. As piece-weight increases, the unit contributions and coverages also increase. See Tr. 18316-17, and infra at 19-20.



The valuable contribution to institutional costs made by ECR mail, and especially by the even more price-sensitive saturation portion of ECR, cannot be taken for granted. Saturation mail offers the best opportunity of any mail category for postal volume and revenue generation to offset competitive and technological inroads in other areas (and to regain former saturation mailers that have shifted to private delivery due to high saturation postage rates). However, saturation mail is also the mail category most at risk of diversion to non-postal delivery alternatives -- either as a result of saturation mailers losing customers to competitors, or saturation mailers themselves leaving the postal system and becoming direct competitors of the Postal Service, as has occurred and will continue to occur unless postal rates reflect the realities of the competitive marketplace.

**B. Saturation Mail's Value To Small Businesses And The American Consumer.**

In their direct testimony, SMC witness Buckel and AISOP witness Otuteye stressed the value of saturation mail to consumers. Through their collaborative efforts, mailers working with small business entrepreneurs develop advertising campaigns that bring important shopping information, services, and bargains to American consumers. Through the geographic targetability and coverage of the Postal Service's delivery network, this advertising information provides shoppers with valuable information about goods and services convenient to where they live. That value is, in fact, in the vision statement of Money Mailer, Inc:

"To help businesses get and keep more customers and to help consumers save money every day." Tr. 14495.

One example was working with a startup closet design business with virtually no customers, allowing the customer to purchase ads with installment payments, which helped his business "take off" and become a regular advertiser. Tr. 14498.

Both Buckel and Otuteye described in detail the importance of saturation mail to small businesses. Saturation mail serves hundreds of thousands of small retail and

service businesses of every description, including individual entrepreneurs and service providers. For many if not most of these small businesses, saturation mail is a vital communications link that enables their businesses to attract customers, and to survive, thrive, and grow. Tr. 12081-90 (Buckel), 14496-501 (Otuteye).

Buckel testified that "the ultimate customers of our mailing programs are consumers." Tr. 12089. He pointed out the high response rate to mail programs, which is the "ultimate test of consumer acceptance." Tr. 12090. In addition, mail programs provide an effective means for "value-conscious consumers" to comparison shop and find bargains on goods and services in their neighborhoods, which is "a convenience that for many time-pressed consumers is as valuable as a bargain price." *Id.*

**II. AFFORDABLE, COMPETITIVE SATURATION RATES ARE A NECESSITY TO PREVENT FURTHER EROSION OF POSTAL SERVICE ADVERTISING VOLUMES AND REVENUES AND FOR IT TO HAVE ANY PROSPECT OF REGAINING LOST VOLUMES AND REVENUES.**

**A. Saturation Mail Faces Intense Competition from Newspapers and Private Delivery Companies, Which Makes Postal Service Volumes and Revenues Highly Susceptible to Diversion.**

The intensely competitive nature of the market in which saturation mailers compete, and the resulting high price sensitivity of saturation mail, are well recognized by the Commission, the Postal Service, and particularly by the competitors whose trade associations (the Newspaper Association of America and Association of Alternate Postal Systems) have intervened to urge higher saturation mail rates and continuation of a non-cost-based pound-rate structure.

AISOP witness Otuteye explained the reasons for the high price sensitivity of saturation mail:

- small business customers constrained by limited advertising budgets;
- larger companies with fixed media budgets who can demand and get lower prices from newspapers and private delivery companies;

- the high franchisee failure rate following the R94-1 rate increases that could not be passed on to customers or absorbed by the franchisee; and
- the diversity of competition from daily newspapers, weekly newspapers, and free distribution shoppers distributed by private delivery or in news racks, all of which have low distribution costs. Tr.14501-03.

According to Otuteye, because of the disparity between the postal rate structure and the competitors' costs, "they can always beat us in price." Tr. 14503.

Buckel testified that the viability of the saturation mail industry depends on its ability to be competitive for the distribution of retail advertising preprints for which the competition "is fierce." Tr. 12090. His competitors are the same as Otuteye's, although he stressed the increasing threat of diversion to private delivery, citing Distribution Systems of America in the New York and Philadelphia markets - - "a growing and vibrant private delivery program and a significant threat to direct mail programs since its cost is dramatically lower than the use of mail." Tr. 12090-1.

**B. High Saturation Mail Rates Have Caused a Decline in the Postal Service's Market Share.**

The newspaper and private delivery industries have tried to portray the Postal Service's participation in the delivery of advertising materials to American households as a sinister plot to drive them out of business and as a perversion of its traditional mission as an agency of the government. The fact is the Postal Service has always been a participant in the market for delivery of advertising materials, even when it was a Cabinet Department prior to the Postal Reorganization Act. A large part of its real function, before and since reorganization, has been to facilitate commerce and trade through the delivery of all the articles essential to the economy, whether transactions between businesses, or transaction between businesses and consumers. The Postal Service fuels the American economy through the delivery of vital documents,

bills and remittances, products like periodicals, books, and parcels, and, yes, even advertising materials to American households.

Contrary to the perception that newspapers and private deliveries company would have the Commission believe, the Postal Service has been losing ground in this important product line as a result of large postal rate increases implemented since 1970 for third-class mail, now Standard A mail. Buckel's rebuttal testimony provides stark evidence about the nature, amount and cause of this decline. Tr. 17241-44. The first business that the Postal Service lost was solo saturation mail distribution of retail preprints when, as a result of large rate increases in the 1970s, saturation mail's share of a growing preprint market declined from a 30% share to 10%. Tr. 17241.

Although solo saturation mail never recovered from high postal rates, the Postal Service and saturation mailers gained ground in the early 1980s after the introduction of carrier route presort discounts and the shared mail concept. But this gain was set back by the large rate increases recommended by the Commission in its Docket R87-1 decision. Saturation volumes again declined as newspapers shifted TMC products from the mail to private delivery, which began a rapid expansion. Saturation mail was left with retail preprints under one ounce and single sheet inserts. Tr. 17242-43. The historical fact is that "saturation mail constitutes a smaller proportion of both third class/Standard A and total mail volume than in 1986, prior to the R87 rate increase." Tr. 17243.

As Buckel testified:

"It is a myth that private delivery and newspaper preprint distribution is 'vulnerable' to saturation mail competition. The vulnerability is in the other direction." Tr. 17244.

The reality is that newspaper and private delivery distribution of retail advertising preprints is healthy, growing and an increasing threat to advertising materials that are, historically and properly, delivered through the mails. The only way to prevent further

erosion of postal volumes and revenues is to bring "postal rates for saturation mail . . . more in line with costs and the marketplace." Tr. 17244.

C. **Maintaining High Saturation Mail Rates. Whether Through An Artificially High Pound Rate or An Arbitrary Redistribution of Institutional Costs. Would Harm Saturation Mailers, the Postal Service and the American Consumers Whom They Serve.**

1. **The Need For A Lower, More Cost-Based ECR Pound Rate.**

The record in this proceeding is clear that weight has little effect on either the costs or the rates charged by newspapers and private delivery companies for retail advertising preprints. Tr. 17245-6; 17250-1; 17260; 17273-4; 12111. It is equally certain, as established on this record and on the record of the MC95-1 proceeding, that postal costs above the 3.3-ounce ECR breakpoint do not increase "in a direct 1-to-1 ratio with increased weight." Tr. 12091. That is not to say that increased weight has *no* effect on costs. Even under the Postal Service's proposed reduced pound rates, there would continue to be a very substantial rate charged for weight over the breakpoint, although less than the current illogical 100 percent weight-related pound rate.

The illogic of the current rate structure was described by Buckel, in response to an AAPS interrogatory asking whether he believed that "the cost of delivering 14-ounce pieces exceeds the cost of delivering 4-ounce pieces:"

"For a 14-ounce piece, the rate is 48.3 cents. The 14-ounce piece is 3 -1/2 times heavier than the 4-ounce piece, and is charged exactly 3 -1/2 times the postage. I believe the 14-ounce piece may have a higher cost than the 4-ounce piece, but surely nowhere near 3-1/2 times as much." Tr. 12113.

Buckel noted that the Postal Service's proposal "would moderate this effect somewhat," so that for a 14-ounce piece,

"the pound rate element represents 92% of the total postage -- compared to 100% under the current rates. I think that this still overstates the weight effect, but it is certainly a step in the right direction compared to the current 100% weight-related postage charge." *Id.*

The irony of the current rate structure, according to Buckel, "is that the more successful a saturation mail program becomes, the greater the incentive to convert that program to private delivery." Tr. 12115.

The reality of the marketplace position of the Postal Service vis-a-vis newspapers or private delivery companies was captured in an exchange between Commissioner LeBlanc and Buckel (Tr. 17270-1):

"COMMISSIONER LEBLANC: Mr. Buckel, just one clarification. Did I understand you to say that your inserts are more vulnerable to being taken to the newspapers than the newspapers were to you?

THE WITNESS: Absolutely.

COMMISSIONER LEBLANC: And why is that?

THE WITNESS: The lower cost structure in pricing of newspapers for their comparable insert makes it much easier for them to attract business from us. I use a real-world example, if I may, for a second.

We had a one-ounce piece from a large customer on Long Island. My rate for that was approximately \$50 a thousand. We lost that to a newspaper whose rates - - the rate charged was about \$35 a thousand, which is about my postage cost.

So, I couldn't have been competitive at that rate, because that didn't even cover postage. Yet, the newspaper was able to take it at that rate and have an adequate profit margin in order to take the business.

So, their lower cost structure allows them to price for market share."

As Buckel emphasized, this lower cost structure is due to the artificially high pound rate, not to any inherent cost structure difference between postal and newspaper/alternate delivery. "I feel very strongly that the Post Office cost structure would allow an even lower level of pricing for my kind of mail." Tr. 17276. The cost evidence in this record confirms this.

2. **The Folly Of Chown's Arbitrary "Weighted Attributable Cost" Pricing Scheme.**

NAA witness Chown's latest version of her previously-rejected "functionalized institutional costs" -- what she now calls "weighted attributable costs" -- is clearly a device aimed at driving up rates for price-sensitive ECR saturation mail that competes with newspapers. Her concept has no economic meaning or foundation, and moreover, conflicts with sound pricing principles.

Chown conceded that her weighted attributable costs have no economic meaning, and she tried to claim that they are not even costs at all, but merely a "metric." Tr. 13307, 13311. But as Advo rebuttal witness Crowder pointed out, "they represent dollars that, for pricing purposes, are taken from the attributable costs of some subclasses and added on top of those for other subclasses, notably ECR." Tr. 18351. Although Chown pretended otherwise, the effect of her proposal is to shift attributable costs among the subclasses for "pricing purposes" in a manner that results in "weighted attributable costs" for ECR mail that are 65% greater than actual ECR attributable costs, while other classes like First Class get reductions from their attributable costs. These skewed "wac" costs become the base for pricing markups.<sup>2</sup> As Crowder described:

"For ECR mail, her weighted attributable costs are nothing more than attributable costs *marked up by 65%*, upon which a *further markup* is applied to derive an additional contribution. Her "metric" should be rejected for what it is: a meaningless, biased contrivance." Tr. 18351 (emphasis added).

Chown's proposal suffers from another conceptual flaw. She purports that her "wac" metric will better enable the Commission to assess the relative "benefit" that the subclasses receive from institutional costs. Her attempted linkage of her weighted attributable costs to a subclass's "benefit" from institutional costs is, by itself, suspect.

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<sup>2</sup> One might wonder whether the acronym for weighted attributable costs -- "wac" -- refers to their intended effect on ECR rates, or to the lack of rationality and economic meaning underlying their concept.

An even more fundamental problem is that her method simplistically assumes that each class “benefits” from institutional costs in some proportional way according to its attributable costs, weighted in some manner by postal cost function. For delivery costs which are the main focus of her concern, this amounts to an assumption that on a proportionalized unit cost basis, each class benefits equally from the delivery institutional costs.

As Crowder explained, this assumption is false. The size of the current institutional cost pool for the delivery function is due, at least in part, to service requirements that are not equally (or proportionally) caused by all classes.

“[A] significant part of this institutional cost can be considered incremental to First Class; if First Class were eliminated from the system, there undoubtedly would be a substantial system restructuring which would eliminate a significant amount of institutional cost. Although this cost cannot be easily measured, it nevertheless exists.” Tr. 18348.

Chown’s proportional equality of benefit assumption is further blurred by differences in service deferrability by class. It cannot be simply assumed that a deferrable class benefits equally on a pro rata basis from the institutional delivery costs as a nondeferrable class. Moreover, deferrability may help to keep the size of the institutional cost pool down from what it would otherwise be. These kinds of issues, which lie hidden in Chown’s construct of a purported metric for measuring “relative institutional cost benefit,” would necessarily come to the fore under any attempted application of her pricing method. These added complexities would come on top of the fact that her approach would require a complete overhaul of the traditional evaluation and balancing of the statutory pricing criteria. Tr. 18351-53.

The greatest flaw in Chown’s approach, however, is also the most obvious: its clear purpose to depart from sound pricing principles by targeting price-sensitive competitive mail for large rate increases. Speaking from the standpoint of a businessman with experience operating in a highly competitive environment, SMC



rebuttal witness Buckel aptly summed up the ultimate absurdity of Chown's skewed approach:

"A striking aspect of Chown's proposal is its methodological number shuffling, 'weighting' this cost up (ECR's) and that cost down to come up with a non-cost base for a pricing markup.

"What is lost in this shuffle is the ultimate objective of setting prices that make sense, reflect real costs, and meet the needs of the market. To do this, you have to take into account the varying price sensitivities of the customers. That, however, is not NAA's objective." Tr. 17247.

As Buckel elaborated, failure to price on the basis of differing cost and demand characteristics is ultimately counterproductive:

"If we were to try to price our services to extract increased markups and margins from our most price sensitive customers (preprint advertisers), for the benefit of our relatively less price sensitive customers who have fewer competitive choices, we would fail. Rather than increasing our contribution from price sensitive advertisers, we would lose them to competitors, along with the contribution they currently make." Tr. 17247-48.

In the long run, even those less-price-sensitive customers who are the intended beneficiaries of non-market-pricing will be worse off:

"Our other advertisers, the ostensible beneficiaries of this pricing scheme, would lose, too. If we could not raise their rates sufficiently to recover the lost contributions, we would have to either shift to private delivery or go out of business." Id.

The Postal Service is subject to these same market realities. This is especially true with respect to the highly competitive saturation mail market, where the Postal Service faces two levels of competitive risk. First, its saturation mail customers can lose business to non-postal competitors, reducing USPS revenues and jeopardizing the ability of its customers to compete and to continue mailing. Second, its customers themselves can abandon postal delivery and switch to alternate delivery, taking their entire volume and contribution out of the postal system and becoming themselves Postal Service competitors. This is precisely what has happened in the past (caused by

high postal rates and a rate structure out of line with costs and demand), and it is continuing to happen. Tr. 17241-43. As Buckel concluded, the only way the Postal Service can succeed in dealing with the market realities it faces is with a pricing focus on the marketplace. "Artificial pricing schemes like NAA's would do just the opposite, to the detriment of the Postal Service and all customers." Tr. 17248.

**III. THE POSTAL SERVICE'S PROPOSED REDUCTION IN THE ECR POUND RATE IS COST JUSTIFIED, MODEST, AND LONG OVERDUE.**

The Postal Service here, as in Docket MC95-1, has proposed to reduce the pound rate for ECR mail to bring rates more in line with costs. Its proposal is, in fact, modest. In recognition of the indisputable fact that ECR costs above the breakpoint are not 100% weight-related, it proposes to:

- (1) reduce the pound-rate element applicable to pieces above the 3.3-ounce breakpoint from 66.3¢ per pound to 53¢ per pound, and
- (2) correspondingly increase the piece-rate element applicable to such pieces. For saturation mail, the piece charge would increase from zero to 3.2¢.

This is consistent with the fact that the costs of handling different-weight pieces above the breakpoint are not exclusively weight-related, but instead include significant piece-related handling costs.

The moderate nature of the USPS proposal is shown in the following table comparing, for the current and proposed saturation mail rates, the percentage change in rates as weight increases above the breakpoint:

**Current and Proposed Rates for ECR Saturation Mail**

Weight (oz.)	Current Rate (¢)	Rate Increase Compared To A 3.5 oz. Piece	USPS Proposed Rate (¢)	Rate Increase Compared To A 3.5 oz. Piece
3.5	14.5	0%	14.8	0%
7.0	29.0	100%	26.4	78%
10.5	43.5	200%	38.0	157%
14.0	58.0	300%	49.6	235%

Compared to the current rate structure where the rate doubles as weight doubles (a 100% rate increase), the Postal Service's proposal would produce a 78% rate increase as weight doubles. This proposed weight-rate relationship would still be quite high (particularly compared to the low weight-cost relationship shown on this record), but it is clearly a significant, albeit modest, improvement in the rate structure.

**A. The Current ECR Pound Rate Is Clearly Excessive, Defies Common Sense, And Distorts The Market.**

The evidence on this record, both qualitative and quantitative, proves that the current ECR pound rate is greatly excessive and that even the proposed rate is quite high, relative to weight-related costs. Rates for saturation mail above the breakpoint are based solely on the pound rate, with a "zero" piece-rate element -- as though costs were purely weight-related with no piece-related cost. Postage doubles as weight doubles. It doesn't require cost analyses or testimony from costing experts to know that this counter-intuitive, purely pound-rated structure is non-cost-based and overcharges weight in relation to costs, as Buckel and other witnesses have testified. Tr. 17244-46.

While the cost evidence on this record conclusively shows that weight has only a moderate effect on ECR postal costs (as described in the following sections), there are other important reasons why the pound rate should be reduced as proposed by the Postal Service:

- Weight is not a significant factor in the delivery costs and rates offered by newspapers and private delivery companies that compete with saturation mailers. Tr. 12111, 17245-46, 17273-75.
- By contrast, the delivery costs and rates that saturation mailers can offer are dictated by the illogically high ECR pound rate, giving their competitors a substantial but artificial competitive advantage. Tr. 12091-92, 17270-71, 17275-76.
- As a consequence, saturation mail's competitive position in the market has eroded to the point where it is now largely priced out of the market for all but light-weight preprints. Tr. 12091-92, 17241-44.

The proposed pound rate, as Buckel explained, will not eliminate this disparity. Even with the lower pound rate, saturation mail would still be "priced out of the market" for traditional preprints, but it would at least "enable us to retain the preprint business we currently have" and "help us compete at the margin for some portion of the lighter-weight preprint business, particularly under 1-ounce." Tr. 12092. The proposal would also allow saturation mailers to expand circulation in existing and new markets, and would encourage privately-delivered shoppers and newspaper TMC programs that previously left the mail because of the high pound rate to consider returning to the mail. Id.

Noticeably, opposition to the proposed pound rate comes not from the mailing industry, but from competitors -- NAA and AAPS, representing the newspaper and alternate delivery industries. Yet despite their rhetoric, neither NAA nor AAPS can claim, with a straight face, that the costs for ECR mail pieces above the breakpoint are purely weight-related. In truth, what they seek is to perpetuate an artificially high, non-cost-based pound rate that will protect them from competition

**B. The Proposed Pound Rate Is High In Relation To Weight-Related Costs.**

**1. McGrane's Analysis.**

In this proceeding, USPS witness McGrane sponsored a weight-cost study for Standard A mail (USPS-ST-44) that updates and refines the Christensen study presented as a library reference in Docket MC95-1. The new study includes costs

for all cost segments (not just mail processing like the prior study). It also includes separate results for ECR mail in total and for ECR flats. In response to interrogatories, McGrane also provided an analysis that adjusts for worksharing cost differences by weight cell. Tr. 7628-38.

Like the various studies preceding it, the McGrane analysis shows that costs decline over the first several ounces, then remain relatively constant to seven ounces, and thereafter gradually rise. The slope of the curve beyond the breakpoint is nowhere near as steep as the current pound rate.

## **2. Crowder's Refined Analysis.**

In her rebuttal to ABA/NAA witness Clifton and AAPS witness Bradstreet, Advo witness Crowder refined McGrane's analysis of ECR costs. First, Crowder analyzed costs for ECR letters and flats separately. Second, in weight cells above the breakpoint, she shifted all volumes and costs identified as "letters" into flats, because letters weighing more than the breakpoint weight are treated for rate purposes as nonletters. ADVO-RT-1 at 7-8, Tr. 18310-11, 18320-21. These refinements eliminate two criticisms of McGrane's analysis.<sup>3</sup> Crowder also accounted for work-sharing differences by calculating separate cost curves for non-workshared ECR mail (basic non-drop shipped) and for fully-workshared ECR mail (saturation drop shipped),

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<sup>3</sup> Specifically, they correct for (1) heavy weight "letters" above the breakpoint; and (2) an inconsistency between McGrane's results for ECR flats and ECR total mail. When Val-Pak witness Haldi tried to subtract McGrane's flat costs from his "total ECR" costs -- to derive what Haldi thought would be the remaining "letters plus parcels" costs -- he got seemingly anomalous results, including "negative costs" in some weight increments. VP/CW-T-1 at D-9, D-14; Tr. 15160, 15165. This "anomaly" was due to the fact in McGrane's "total ECR" analysis, he distributed shape-related rural and city delivery carrier costs to all weight cells on the basis of the overall average mix of letters, flats, and parcels, rather than the actual letter/flat/parcel mix in each particular cell. These "shape-normalized" costs understate true costs in cells that have a higher than average proportion of flats or parcels, and vice versa. McGrane's separate "flats only" cost analysis correctly distributed these shape-related city and rural delivery costs to flats. Thus, subtracting the correct "flats only" cost from the shape-normalized "total ECR" costs (as Haldi did) does not produce true "letters plus parcels" cost, but rather meaningless numbers (including negatives) that bear little relation to true costs. Crowder's analysis avoided these problems by counting heavy weight letters as flats and by analyzing letter and flat costs separately.

based on the USPS estimated worksharing cost differentials and the actual mix of workshared mail in each weight cell.

Her refinements improve upon McGrane's analysis. They provide a better analytic framework for assessing weight-related costs, by separating out the cost effects of shape and worksharing characteristics. Thus, her resulting cost curve eliminates or mitigates some of the seeming "anomalies" in McGrane's results (e.g., the anomalously high unit cost in the 3-4 ounce increment).

**a. ECR Weight-Related Costs Are Small In Relation To The High Proposed Pound Rate.**

Crowder's analysis demonstrates the small effect of weight on ECR costs. For non-workshared flats, the unit costs do not increase until beyond the breakpoint, and then rise gradually through 15 ounces, with a sharper jump in the last 16th ounce increment. For fully-workshared flats, weight (as expected) has even less effect. Costs do not begin increasing with weight until beyond 7 ounces, and then increase only slightly through 15 ounces, peaking at less than 11¢ at 16 ounces. ADVO-RT-1, Figure 1, Tr. 18320.

Below the breakpoint, both letter and flat costs decline over the first few ounces. This pattern, which has been well known for some time and is explained by logical operational and mail makeup characteristics, disproves Clifton's speculation that the Standard A minimum-per-piece rate structure is not cost justified. Tr. 18311-15.

Above the breakpoint, weight-related costs are small no matter how the cost data are viewed. Even using the highest estimate of ECR weight-related costs from her analysis, Crowder showed that weight-related costs between the breakpoint and 16 ounces are only about 18.1¢ per pound for basic-level non-workshared mail and only 7.4¢ per pound for saturation drop shipped mail -- a fraction of the USPS proposed 53¢ pound rate for non-drop shipped mail and 42¢ per pound for DDU drop shipped mail. ADVO-RT-1 at 14, Tr. 18317. Moreover, as Crowder pointed out, these per-pound cost

estimates -- based on a simple "straight-line" between the unit costs at the 3rd and 16th ounce increments -- significantly overstate the likely true weight-related cost relationship over that range because of the anomalously high unit cost in the last 16th ounce increment.<sup>4</sup>

**b. Pound-Rated ECR Mail Will Make A High Unit Contribution And Implicit Cost Coverage At The Proposed Pound Rate.**

Based on the unit costs developed in her analysis, Crowder calculated the rates, costs, contribution and implicit cost coverage for ECR mail in the 2-3-ounce increment (averaging 2.5 ounces in weight) and the 15-16-ounce increment (averaging exactly 16 ounces). As shown below, at the Postal Service's proposed rates, pound-rated ECR mail will make a larger per-piece and percentage contribution than does mail below the breakpoint. This is especially true in the case of saturation drop shipped mail (ADVO-RT-1 at 13, Tr. 18316):

**Costs, Rates, And Implicit ECR Cost Coverages  
For 2.5- and 16-ounce Flats**

<u>Basic, no drop ship</u>	<u>2.5 oz.</u>	<u>16 oz.</u>
USPS Proposed Rate	16.4¢	58.8¢
Unit Cost	<u>9.6¢</u>	<u>27.7¢</u>
Unit Contribution	<b>6.8¢</b>	<b>31.1¢</b>
Implicit Cost Coverage	<b>171%</b>	<b>211%</b>
<u>Saturation, DDU entry</u>		
USPS Proposed Rate	11.8¢	45.2¢
Unit Cost	<u>3.3¢</u>	<u>10.8¢</u>
Unit Contribution	<b>8.5¢</b>	<b>34.4¢</b>
Implicit Cost Coverage	<b>353%</b>	<b>420%</b>

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<sup>4</sup> Id. at Tr. 18317-18. Costs in the last 15-16 ounce increment jump about 8¢ -- double the next largest increment-to-increment variation. As Crowder explained, this is likely an anomaly due to the facts that (1) volume in this increment is very small, constituting only 0.1% of total ECR flat volume; (2) 98% of the only 11 million pieces in this increment are basic-level ECR mail; and (3) the average weight of mail in this increment is exactly 16.0 ounces which suggests some data anomaly or error. Tr. 18313-14.

Here again, the estimate for the 16th ounce increment overstates the likely effect of weight on costs (and correspondingly understates the unit contribution and cost coverage) because the aberrationally high cost for 16-ounce pieces is substantially higher than the rest of the cost curve below the 16-ounce increment.

3. **The Relationship Between Shape- And Weight-Related Costs And The Letter/Flat Cost Differential Further Proves That The Current Pound Rate Is Greatly Excessive.**

As USPS witness Moeller acknowledged, the ECR letter/nonletter unit cost differences estimated by the Postal Service reflect not only shape-related but also weight-related cost differences. Tr. 7/3139. This fact has important implications on the pound rate issue. Specifically, it further demonstrates that the current ECR pound rate (and even the lower rate proposed by the Postal Service) are excessive in relation to weight-related costs.

This issue was addressed extensively in Docket MC95-1 (albeit overlooked in the Commission's decision). There, Val-Pak witness Haldi proposed a larger passthrough of the ECR letter/nonletter cost differential while opposing any reduction in the pound rate. In rebuttal, Advo witness Crowder demonstrated the major inconsistency in Haldi's proposal. The letter/nonletter cost differential, based on the *average* cost difference between letters and nonletters, included the combined effects of both shape *and* weight, not just shape alone. Consequently, Haldi's letter/nonletter rate differential, based on a passthrough of the average cost differential, necessarily overstated shape-related cost differences. MC95-1 Tr. 14924-27. She then demonstrated that the USPS-proposed lower pound rate substantially exceeded the *maximum* weight-related costs for ECR mail even under the extreme assumption that the *total* average cost difference between ECR letters and nonletters is due *solely* to weight, rather than shape. MC95-1 Tr. 14927-29.

In this case, Haldi now recognizes this interrelationship between the letter/flat rate differential and the pound rate. While expressing uncertainty concerning the



precise effect of weight on costs, he now recommends that the Commission “adopt a conservative approach and accept witness Moeller’s proposed pound rates for Standard Mail A.” Tr. 15162. The cost Haldi assumed for his “moderately high weight-related cost scenario” was derived from an analysis of saturation mail unit costs, where he noted that the higher the assumed weight-related cost effect, the lower the shape-related cost effect. Tr. 15057-58.

In response to an NAA interrogatory, Haldi explained that Moeller’s proposed pound rate is “conservative” because of this interrelationship between shape- and weight-related costs. Even at his “moderately high” assumed weight-related cost, the remaining non-weight-related (i.e., shape-related) unit cost for saturation nonletters would be *lower* than that for saturation letters. Tr. 15172. Noting that “this result is already hard to swallow” because it would imply a negative shape-related letter/nonletter cost differential, Haldi concluded:

“Using even higher pound rates, such as those last approved by the Commission, would cause a further reduction in the unit cost of nonletters below the corresponding cost of letters. In light of these considerations, I consider witness Moeller’s recommended pound rate to be conservative.” Id.

Haldi’s analysis is thus consistent with Crowder’s conclusion that the Postal Service’s reduced pound rate is still high in relation to true weight-related costs, and that it substantially over-recovers weight-related costs. Haldi effectively concedes that the proposed pound rate alone would more than cover the entire letter/flat cost differential, even without a separate shape-based letter/flat rate differential.

#### **IV. NAA'S CRITICISMS OF THE PROPOSED POUND RATE IN ITS "MEMORANDUM OF LAW" ARE WITHOUT MERIT.**

On March 26th, NAA filed a "Memorandum of Law" ["NAA Memo"] in which it challenges the Postal Service's proposed ECR pound rate on a variety of grounds.<sup>5</sup> Although NAA cannot be accused of having missed the kitchen sink, its arguments are appallingly thin in depth and content. It claims uncited "record support" for arguments where there is none, and indeed, where the record proves the opposite. It mischaracterizes and twists the record evidence that it does cite, relying on surmise and innuendo in lieu of facts. It presents unsupported policy and legal-sounding arguments that are nothing more than a thinly-veiled attempt to maintain an artificially high, non-cost-based rate structure to protect competitors from competition.

In a number of its arguments, NAA does not address all of the evidence on the record. This is particularly noticeable with respect to the weight-cost analyses. Although it addresses superficially the analysis presented by USPS witness McGrane, NAA makes virtually no mention of the testimony and analyses presented by Advo rebuttal witness Crowder.<sup>6</sup> It may be that NAA has said all that it can or dares say about Crowder's testimony, or that it intends to address her testimony in its initial brief. On the other hand, it may be that NAA intends for tactical reasons to hold its fire until reply brief, thereby depriving other parties of an opportunity to respond to its reply "criticisms."

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<sup>5</sup> "Newspaper Association of America Memorandum of Law on the Pound Rate for Standard A Enhanced Carrier Route Mail," March 26, 1998.

<sup>6</sup> NAA mentions Crowder's testimony twice in passing, stating only that she provided no "independent" cost studies or data. NAA Memo at 6, n. 11 and 16. In fact, Crowder's testimony and analyses directly address and rebut many of the "shortcomings" NAA alleges in McGrane's analysis, and provide substantial additional support for the manifest conclusion that costs above the breakpoint are nowhere near 100% weight-related -- contrary to the current pound rate and rate structure.

**A. NAA's Self-Serving View Of The Postal Service's "Mission."**

NAA rails that the proposed reduction in the excessive pound rate is inconsistent with the proper "mission" of the Postal Service. NAA Memo at 20-21. Under NAA's view, the Postal Service should not compete with enterprises in the private sector, and it should ignore the needs of its customers and the realities of the marketplace in developing its proposed rates.<sup>7</sup> That would certainly suit competitors' interests, but it would not serve the interests of the Postal Service, the users of the postal system, or consumers and the economy that benefit from competition.

Indeed, NAA's attempt to cast the pound rate issue as something sinister and incompatible with the Postal Service's "mission" is most peculiar. NAA's linkage between the ECR rate structure and the "mission" is tenuous, at best. What NAA is really asking is that the pound rate be kept artificially high in order to protect competitors from competition. As the courts have held, however, in setting rates in a competitive environment, "the PRC's task is to protect *competition*, not particular competitors." Direct Marketing Association v. United States Postal Service, 778 F.2d 96, 106 (1985) (emphasis in original).

The Commission's role is neither to set postal rates artificially low to protect the Postal Service from competition, nor to set rates artificially high to protect competitors from competition. The best way to assure this proper balance of competitive considerations is to establish cost-based rates. In this case, the ECR pound rates proposed by the Postal Service, although a move in the direction toward a more cost-based ECR rate structure, still fall short of a truly cost-based structure. Consequently,

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<sup>7</sup> NAA even finds something sinister in the fact that "mailers may have urged the Postal Service to propose to reduce the pound rate." NAA Memo at 22. It is neither a secret nor sinister that saturation *and* nonsaturation ECR mailers have for some time been urging the Postal Service and the Commission to reduce the excessive ECR pound rate. It's been on the public record for years. There is nothing unusual or untoward about it.

NAA and AAPS do not have any legitimate claim -- legal, policy, or otherwise -- that this more-cost-based proposed pound rate is in any manner inconsistent with the Postal Service's proper "mission."

**B. NAA's Misdirected First Class "Discrimination" Argument.**

NAA claims that the proposed ECR pound rate is "discriminatory" -- based on comparisons to First Class extra-ounce rates. NAA Memo at 25-27. Its argument boils down to the absurd contention that because the First Class rate structure may not be cost based, it would be "discriminatory" to establish cost-based rate structures in other classes. To the extent there is any discrimination problem, it is within the First Class rate structure, not the proposed ECR rate structure.

In setting the First Class rate structure, the Commission's primary focus has always been on the rate for the first ounce of single-piece mail -- the First Class rate most commonly used by "Aunt Minnie." To the extent that the First Class rate structure is less cost-based than those for other classes, this has been due to overriding policy considerations.<sup>8</sup> Absent those considerations, the single-piece first-ounce rate would undoubtedly be higher than it is today.

These policy considerations do not extend to Standard A mail. ECR mail is high-density bulk mail that is used by commercial businesses and organizations. There is no policy reason to perpetuate a non-cost-based rate structure or to maintain artificial cross-subsidies between mailers in this subclass. In fact, doing so would be counterproductive.

If extra-ounce First Class mail is being charged too much in relation to the first ounce, the remedy is to modify the First Class rate structure by increasing the first-ounce rate and reducing the extra ounce charge.

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<sup>8</sup> Indeed, in the past, parties like the Office of Consumer Advocate and the Greeting Card Association have specifically argued that the first-ounce rate should be cross-subsidized.

**C. NAA's Misconceptions About Rate Design Models And Algorithms.**

NAA criticizes witness Moeller for "abandoning" the Commission's ECR rate design methodology by making the pound rate an input into the Commission's formula rather than a mathematical output. NAA Memo at 3-4. It also accuses Moeller of "simply play[ing] around with his spreadsheet until arriving at a rate to his liking" (*id.* at 4, n. 7), and extols the supposed virtues of a rate design model that simply spits out an arbitrary pound rate as a consequence of "other cost-based decisions" (*id.* at 26). These arguments overlook the proper purpose of *any* rate design model which should be to ensure that *all* elements of the rate structure (whether technically labeled as inputs or outputs of the model) are reasonably cost based and produce an *overall* rate structure that is cost-based and makes sense.

**1. The "Input v. Output" Misnomer In Rate Design Models.**

NAA criticism of Moeller for making the pound rate an "input" into the rate design equation rather than an "output" misconstrues the nature and ultimate purpose of rate design models, whether the Commission's or Moeller's. Moeller and the Commission, in fact, use the same general rate model. In that model, three interrelated rate elements -- the minimum-per-piece rate below the breakpoint, and the per-piece and per-pound rates above the breakpoint -- must be determined. Regardless of the approach, at least one of these rate elements has to be "selected" as an "input" to the model's algorithm, allowing the other two to be calculated as "outputs." In R90-1 and MC95-1, the Commission "selected" a piece rate for pound-rated pieces (based on a presort cost differential), which then solved for both the minimum-per-piece rate and the pound rate. In this case, Moeller "selected" the pound rate and solved separately for the two piece rates.

Even labeling the pound rate as an "output" of the Commission's model -- as though it were immutably determined by the inputs -- mischaracterizes the nature and purpose of the model. The ultimate purpose of any rate design model is to establish *all*

of the subclass rate design rate elements. In the mathematical model, *all* of the input and output rate elements are interactive, and consequently, some elements must be “selected” as inputs while others are labeled as outputs in order for the model to work. Yet all of these elements, whether technically employed as “inputs” or “outputs” in the model, are truly and equally *inputs* into the rate design modeling process. And, all of the resulting subclass rate elements (whether piece or pound rates) are equally *outputs* of the rate modeling process. The model is, after all, simply a tool for developing an overall rate structure that is reasonable and cost-related, and that satisfies the subclass revenue target.

In fact, nothing in the Commission's rate design model precludes adoption of the specific ECR pound rate proposed by Moeller. The problem is not the model, but a built-in assumption in one specific algorithm in the model, and the Commission's apparent belief that the *model* somehow *dictates* that its ultimate recommended pound rate is merely a mathematical byproduct of other rate design decisions. In the past, the Commission has implicitly presumed this algorithm accurately reflected the correct cost relationship between the piece and pound rates. It does not. Moeller simply rectified the shortcomings of this algorithm to better match the piece and pound rates to their underlying piece- and pound-related costs.

## **2. Problems With The Commission's Rate Design Algorithm.**

Under the Commission's R90-1/MC95-1 approach, it selected certain rates and cost differences as inputs to the ECR rate design model and algorithms. The resulting pound-rate output was “an algebraic function of the other decisions [input selections].” PRC Op. MC95-1 at V-254, ¶5642. According to the Commission, this methodology “reduces the pound rate to dependency on a host of other ratemaking decisions, all of which are cost based,” and consequently “there is not much latitude in the pound rate.” *Id.* at V-257, ¶5649. These statements suggest that

the Commission believed its resulting pound rate was correctly based on correct underlying costs.<sup>9</sup> That, however, is not the case.

The Commission's R90-1/ MC95-1 pound rate determinations did *not* come from a "host of cost-based ratemaking decisions." Although the Commission's model did use "costs," they were not the relevant or correct piece- and pound-related costs. Instead, the pound rate was an arbitrary byproduct predetermined by two key "decisions," neither of which was supported by underlying cost analysis:

- (1) The decision to use a model algorithm which arbitrarily fixed the relationship between the saturation minimum-per-piece rate and the pound rate.

This mathematically (and arbitrarily) fixed the pound rate at *4.85-times* the minimum-per-piece saturation rate -- thus dictating the pound rate -- contrary to record evidence showing that weight-related costs above the breakpoint were relatively small.

- (2) The decision to pass through less than 100% of the piece-related cost difference between basic- and saturation-rate mail.

Because of the algorithm's incorrect fixed linkage between the minimum-per-piece and pound rates, the portion of *piece-related* costs that were *not* passed through effectively became treated as *weight-related* costs, arbitrarily increasing the pound rate even more.

Neither of these two "cost" decisions were truly relevant to true piece- v. pound-related costs or to the proper level of the pound rate, yet they together generated a pound rate "output" that bears no real relationship to cost-based rates.<sup>10</sup>

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<sup>9</sup> To the extent these statements might imply that the pound rate is purely an incidental and arbitrary byproduct of the Commission's model, and that the model precludes a cost-based pound rate, this would be a compelling reason to adopt Moeller's modified methodology.

<sup>10</sup> The Commission also assumed that the unit cost difference between letters and non-letters was entirely piece-related. Thus, it implicitly assumed that the entire letter and non-letter unit costs were also purely piece-related. Although this assumption is quite reasonable, based on the analyses presented by McGrane and Crowder in this case, the Commission ignored the obvious corollary: weight-related costs are therefore small.

Contrary to the Commission's and NAA's claim that the rate design model generates as an output a "cost-based" pound rate as a consequence of other "cost-based" rate design inputs, the results of the algorithm actually run counter to the established record evidence on cost relationships and are not in any real sense cost-based.

3. **Moeller's Modified Rate Design Model Addresses the "Fixed Relationship" Embedded in the Commission's Algorithm.**

Moeller understood and rectified this illogic in the Commission's rate model algorithm that mathematically fixed the minimum-per-piece/pound rate relationship. To establish a piece/pound rate relationship that more closely reflected the true piece/weight relationship, he entered the pound rate and the piece rate for pound-rated pieces as "inputs" into the rate design formula, generating the minimum-per-piece rate. USPS-T-36 at 23. This approach, while based on the Commission's model, avoided the problem with the Commission's incorrect "fixed relationship" algorithm.

Moeller's approach is clearly justified. He adjusted the Commission's fixed piece/pound relationship only slightly, but his adjustment permitted him to conservatively recognize, in the pound rate, information on ECR weight-related cost presented by McGrane -- specifically, the fact that costs above the breakpoint are not purely weight-related. It also allowed him to avoid, to some extent, the distortion that less-than-100% presort cost passthroughs would otherwise have had on the pound rate.

Moeller's adjustments to the Commission's algorithm are fully cost supported by the record in this case. By contrast, leaving the algorithm unadjusted, as NAA urges, would arbitrarily dictate a pound rate and rate structure that bear no relation to true weight-related costs. Moeller's only "arbitrary" or non-cost-based decisions were to: (a) adopt rate category passthroughs of less than 100% of the identified cost differences, and (b) select a pound rate that far exceeds the low weight-related costs identified in the McGrane and Crowder cost analyses.



**4. “Playing Around” With Formulas and Spreadsheets.**

NAA tries to make light of Moeller’s use of his alternate formula, claiming that he “simply played around with his spreadsheet until arriving at a rate to his liking.” NAA Memo at 4, n. 7. Contrary to this disparaging characterization, a certain amount of “playing around” is *essential* with any rate design model to insure that the final rate design output -- the overall rate structure, including the pound rate -- makes sense. NAA’s mechanistic approach is just the opposite: it argues that all other rate elements should be plugged in to the equation, and the “fill the gap” pound rate that pops out algebraically from the formula should be adopted uncritically without regard to costs. The Commission itself has rejected this hyper-mechanistic approach, and in fact “plays around” with its own model to avoid unreasonable results.<sup>11</sup>

In sum, there is no reason for the Commission to be wedded to its fixed piece/pound algorithm in its model in preference to Moeller’s alternative. Both models serve the same function. Both require an iterative and judgmental look at the reasonableness of both the “input” *and* “output” design elements, to ensure that *all* are reasonably cost based. In the end, the ultimate test of the validity of any rate structure model is whether it is flexible enough to adequately take into account the cost-based relationships of *all* rate elements, and thereby produce reasonable results.

**D. The Crowder and McGrane Cost Study Analyses Are Reliable And Show A Clear Pattern Of Cost Behavior Consistent With Past Studies And Real World Expectations.**

The ECR cost curves in McGrane’s analysis, and particularly in Crowder’s refined analysis, show a clearly discernible cost pattern: flat or declining costs out to or beyond the breakpoint, rising only moderately with increasing weight beyond the

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<sup>11</sup> In MC95-1, for example, the Commission noted that rote application of its model would have produced an unacceptable increase in the pound rate for the Standard A Regular subclass, so it adjusted other rate element inputs to achieve a targeted pound rate. PRC Op. MC95-1 at V-255, ¶15643.

breakpoint, and unit costs in all ounce increments that are only a fraction of either the current or USPS-proposed rates.

No party has presented any cost analysis to counter these results. Instead, parties like NAA have attempted to cast doubt on these results, claiming thinness of data in the heavier weight increments and focusing on ounce-increment-by-increment variations in unit costs, ignoring the clear overall "big picture" pattern of costs. These are smoke screens designed to cover the weakness of their arguments.

**1. The Big Picture -- Overall Cost Patterns versus Selective Cell-by-Cell "Anomalies."**

Focusing narrowly on cell-by-cell variations in unit costs by ounce increment, NAA proclaims that McGrane's analysis is unreliable because it allegedly produces "widely gyrating results," with unit costs that "vary wildly" above the breakpoint on a "random ride for no apparent reason." NAA Memo at 13, 15. NAA's colorful hyperbole is not borne out by the facts.

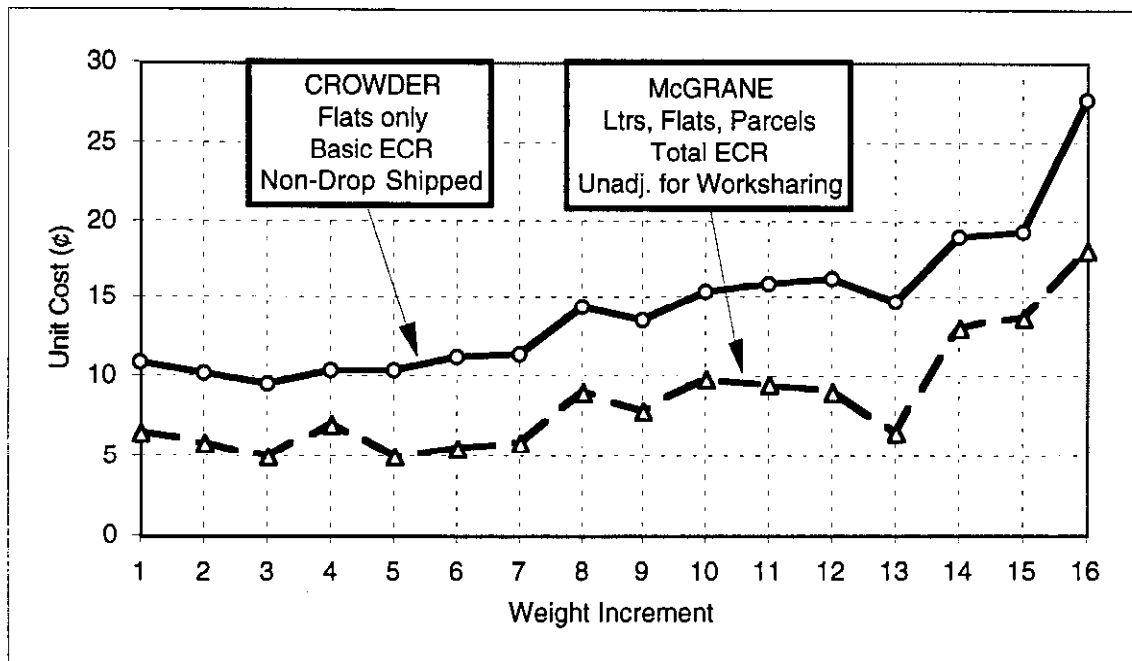
Of the 16 separate ounce increments in McGrane's analysis, NAA focuses specifically on three increments that it finds anomalous: the costs in the 4, 8 and 13 ounce increments. What it overlooks is that aside from these three increments (and the last 16th ounce increment discussed by Crowder), the unit costs over the other increments exhibit a reasonably consistent and clearly discernible pattern -- a cost curve that varies only moderately with weight.

Moreover, after Crowder's refinements to McGrane's analysis, the apparent anomaly at the 4-ounce increment disappears.<sup>12</sup> [NAA curiously does not address Crowder's refined analysis in its memorandum]. The only remaining anomalies cited by

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<sup>12</sup> Crowder's unit costs over the 3- to 7-ounce increments, after adjusting for worksharing and letter/flat differences, form a nearly perfect straight line, with no upward spike at the 4-ounce increment. For non-workshared basic ECR mail, for example, her unit costs over this range are 9.6¢, 10.4¢, 10.4¢, 11.2¢, and 11.5¢. ADVO-RT-1 at Figure 1, Tr. 18320; and ADVO-LR-1.

NAA are at 8 ounces where the cost is moderately higher than the prevailing pattern, and at 13 ounces where the cost is noticeably lower than the prevailing pattern. These relationships are shown in the chart below, comparing McGrane's aggregated, unadjusted ECR unit costs (letters, flats and parcels combined, without worksharing adjustments) with Crowder's adjusted unit costs for ECR basic-level non-workshared flats:



The fact that the 8-, 13-, and 16-ounce increment unit costs are obviously anomalies is, itself, telling. They are anomalous *because* they depart from the otherwise clear *pattern* of the other unit costs. This is the clearest proof that NAA's myopic focus on a few increment-by-increment variations misses the big (and clear) picture.

**2. The Results Are Clearly Reliable Despite Alleged Data Thinness in Higher Weight Increments: A Less Disaggregated Analysis Would Produce An Even Flatter Cost Curve.**

Inherent in any analysis of disaggregated ECR costs by ounce increments is the fact that volumes thin out beyond 7 ounces. Disaggregation by ounce

necessarily results in greater variation in unit costs from ounce to ounce. In this case, McGrane's analysis is substantially more disaggregated than in prior weight cost studies, as he uses single-ounce increments all the way out to 16 ounces rather than aggregating the increments over 8 ounces into fewer multiple-ounce increments.<sup>13</sup>

A less disaggregated approach for the higher weight increments, as employed in the past, would substantially mitigate NAA's purported concerns about data thinness. But as Crowder explained, that would produce an even *flatter* cost curve than that shown in either the McGrane or Crowder results. If the last four ounces were aggregated into a single larger increment, the resulting unit costs would be sharply lower: approximately 18¢ for non-workshared basic ECR flats, in line with the cost pattern in the other increments below 12 ounces. ADVO-RT-1 at 14, Tr. 18317.

As Crowder noted, the relatively flat cost pattern over the first 7 ounces is particularly reliable because that range encompasses 98% of total ECR volumes. Tr. 18313. Beyond 7 ounces, the pattern of unit costs exhibits somewhat greater ounce-by-ounce fluctuation (as would be expected in any disaggregated analysis), but the overall pattern of costs is clear even here. If the data were truly as "unreliable" as NAA claims, one would expect wildly random variations with no discernible overall cost pattern above the breakpoint. The only "random wildness," however, is in NAA's rhetoric.

**3. The Crowder and McGrane Results Are Consistent With All Prior Analyses of the Weight-Cost Relationship.**

The clearly discernible pattern of costs in the McGrane/Crowder analyses -- flat or declining costs out to or beyond the breakpoint, rising only moderately with increasing weight beyond the breakpoint -- is entirely consistent with the cost

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<sup>13</sup> The MC95-1 Christensen Associates study, for example, aggregated data from 9 to 16 ounces into two increments, one for the 9-11 ounce range and another for the 11-16 ounce range. LR MCR-12, Docket MC95-1. While this has the advantage of producing a "smoother" cost curve based on larger volumes per increment, it may also mask some data anomalies that become more apparent in the fully disaggregated analysis, such as the unexplained jump in the last 16-ounce increment.

patterns in every prior study of third class/Standard A costs over the last 15 years. Tr. 18314-15 (Crowder). NAA attempts to denigrate this convincing evidence by claiming that all those earlier studies likewise suffered from “data thinness” problems in the upper weight increments that purportedly make them all unreliable. NAA Memo at 16.

There is a glaring fallacy with NAA’s logic. If all of these various studies -- including the ones on this record -- were, indeed, unreliable because of data thinness, then one would expect that their resulting cost curves would vary wildly from one to another in some random, haphazard manner. Instead, the same general cost pattern emerges from each one. The notion that these supposedly random, “unreliable” unit costs would, by sheer chance, align in the same cost pattern in test after test after test is truly unfathomable, and would defy all notions of statistical probability. The only reasonable conclusion from this consistency is that these repeated cost patterns do, indeed, reliably demonstrate true cost behavior.

**4. Haldi’s Testimony Demonstrates That The Current Pound Rate Is Excessive.**

Looking for any support it can find, NAA cites Val-Pak witness Haldi’s testimony to claim that the weight studies are unreliable and do not warrant a reduction in the ECR pound rate. Haldi provides no such support. To the contrary, he supports the USPS proposed pound rate, and his testimony provides support for an even lower one.

In his testimony, Haldi attempted to compare McGrane’s costs for ECR flats versus total ECR mail. Subtracting McGrane’s flats costs from his separate total ECR costs, Haldi came up with what he *thought* were some “negative unit costs for ECR letters and parcels at five different weight increments.” NAA Memo at 14. NAA quotes Haldi’s conclusion that “serious weight cannot be given to data for flats when the ‘residual’ produces results such as these.” *Id.*, quoting Tr. 15160.

In fact, Haldi misunderstood McGrane's analyses. McGrane's costs for flats are correct, but are not directly comparable to his total ECR costs which were "normalized" to factor out shape-related cost differences between weight cells.<sup>14</sup> Consequently, when Haldi subtracted McGrane's correct flats costs by ounce increment from his shape-normalized total ECR costs, the resulting "residuals" were not "letter and parcel costs" as Haldi presumed, but meaningless numbers -- some of which were negative. Crowder's approach -- analyzing ECR letter and flat costs separately -- avoids this problem, produces correct costs by ounce increment for both flats and letters, and moots Haldi's unfounded concerns about the reliability of the McGrane/ Crowder ECR flats analyses and the underlying cost data.

Once again, NAA's selective recitation of the record is not only wrong, but fails to tell the real story. What NAA omits is Haldi's confirmation that the current ECR pound rate is too high, and that even the proposed rate is "conservative." As noted earlier, Haldi recognized that the interrelationship between shape- and weight-related costs necessarily leads to this unassailable conclusion. Supra at 20-21, and Tr. 15171-72. In the end, Haldi specifically recommended that the Postal Service's proposed ECR pound rate be adopted because it is "conservative" (i.e., too high). Tr. 15162, 15171-72.

**E. Impact of Weight on Delivery Costs.**

NAA claims that McGrane's study "assumes away any possibility that delivery costs are weight-related, and does so by allocating all delivery costs, both city

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<sup>14</sup> See footnote 3, page 17, supra. For total ECR costs, McGrane recognized that the mix of shapes (letters/flats/parcels) varied by ounce increment, but because his objective was to identify weight-related costs, he had to "normalize" for shape differences by using average shape-related delivery costs across all weight cells. Had McGrane instead distributed these shape-related costs to each cell based on the actual shape mix in each cell, his resulting costs by ounce increment would have been "accurate" and comparable to his separate costs for flats -- and would have produced correct "letter + parcel" cost residuals in Haldi's subtraction analysis. But such non-normalized costs for total ECR would not have isolated the effect of weigh, which was McGrane's objective. In his separate analysis of flats costs, he correctly distributed the shape-related flat delivery costs to each cell.

and rural, in proportion to mail volume by pieces,” which it labels as an “assumption that delivery costs are 100 percent piece-related.” NAA Memo at 18. In fact, that assumption is reasonable and accurately reflects the overwhelmingly piece-related nature of city and rural carrier delivery costs. Neither NAA nor AAPS have presented any evidence to the contrary, resorting instead to unsupported supposition.

**1. Rural Carrier Costs Are Entirely Piece-Related.**

The total delivery costs of ECR mail are divided into two cost segments: rural carrier costs (cost segment 10) and city delivery carrier out-of-office costs (cost segment 7). Rural carrier costs constitute 41% of the total ECR delivery costs. NAA’s implication that *any* portion of these rural carrier costs might be weight-related is simply wrong. As Crowder explained in her rebuttal testimony, rural carrier pay (and consequently cost attribution) is based on piece-handling cost allowances by shape, not on weight.<sup>15</sup> Rural carrier costs are unequivocally piece-related. Accordingly, the McGrane and Crowder analyses of ECR flats correctly treat rural carrier costs as strictly piece-related.<sup>16</sup>

**2. Inclusion of Nelson’s Weight-Related Drive Time Costs Would Have No Meaningful Impact On The Cost Curves.**

NAA argues that USPS witness Nelson “contradicts this central assumption” in McGrane’s analysis “by demonstrating that weight does, in fact, affect route driving time.” NAA Memo at 19. This is much ado over almost nothing. Crowder explained why drive time costs are not significantly weight-related and that Nelson’s conclusions are not sound. Tr. 18330. She further explained, for the sake of argument, that even treating all of Nelson’s attributable drive time costs as weight-related would

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<sup>15</sup> Tr. 18330. See, also, Joint Initial Brief of AMMA, DMA, MOAA, PSA, and Advo Concerning City Delivery Carrier Load Time Costs and Rural Carrier Costs, at 15,

<sup>16</sup> Similarly, city delivery carrier access costs are indisputably piece-related. Tr. 18331. NAA does not contend otherwise.

add less than one penny per pound (0.74¢) to the very low per pound costs in the ECR cost curve. Tr. 18330.

3. **Bradstreet's Simplistic Arguments Have Been Thoroughly Disproven By Crowder.**

In support of its bare assertion that weight has a significant impact on city delivery carrier costs, NAA cites AAPS witness Bradstreet's simplistic saturation mail "example." NAA Memo at 20. Surprisingly, NAA makes no mention of Advo witness Crowder's rebuttal testimony disproving Bradstreet's claims. It remains to be seen whether and when NAA will respond to her testimony.

Crowder showed that Bradstreet's simplistic and unrealistic example of a large increase in saturation mail weight misconceives (1) the characteristics of typical carrier routes, loops, stops and volumes in the postal system, (2) the delivery capacity in the system, (3) the factors that affect carrier loops and workload, and (4) the flexibility within the system to handle additional volume efficiently.

Bradstreet's discussion was based on a hypothetical carrier route divided into loops averaging 60 stops per loop, from which he concluded that a 3.3-ounce increase in the weight of a saturation mailing would exceed the carrier's satchel capacity and require extra trips along the loop. In fact, loops of that size are rare. Based on Postal Service data, Crowder showed that city delivery routes average only about 25 stops per loop (less than half the size in Bradstreet's example), and that only 3% of all loops contain 60 or more stops. Stops average less than 13 ounces of mail, producing an average mail weight per loop of only about 20 pounds. This is well below the 35-pound satchel limit, leaving ample capacity to accommodate Bradstreet's additional 3.3-ounce per stop (5 pounds per loop) mailing. Tr. 18325-26.

Crowder further explained that because these data include high volume stops that serve businesses and multiple-delivery residential addresses, they understate the available capacity on typical single-delivery stop loops. After conservatively factoring



out high volume stops and using an average weight of 6.6 ounces per household from the Household Diary Study (more representative of the stop weight for single-delivery residential stops), Crowder estimated that the average "single-delivery" loop receives only about 12 pounds of mail, leaving even greater capacity to accommodate Bradstreet's hypothetical mailing. Tr. 18326-27.<sup>17</sup>

Bradstreet's example is also unrealistic because it ignores the substantial flexibility carriers and supervisors have to deal with unexpectedly high mail volumes, particularly through deferral of saturation mail.

"Carriers and supervisors know, even before the carrier begins casing the day's mail, if they have a particularly large amount of volume to deliver. ECR saturation mailings, because of their deferrability, actually give carriers more flexibility to deal with unexpected volumes than do mailings of other classes." Tr. 18329.

This flexibility includes deferral of the entire mailing or selective deferral of part of the mailing.

"For example, on a particular loop, by carrying out and delivering only the saturation mail for the first half of the loop, and deferring the pieces for the remainder of the loop, the carrier would cut in half the 'additional weight per loop' that Bradstreet assumes." Id.

Crowder emphasized that "this is, in fact, what happens in the real world" (id.), citing as examples her personal observations of carriers deferring saturation mail, and that 30 percent of the volume of Coalition witness Buckel's saturation shoppers is delivered on

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<sup>17</sup> This substantial weight capacity in the delivery system (which Bradstreet overlooked) is due to factors other than weight. Crowder provided a detailed explanation of the multitude of complex non-volume-related factors that affect the design of loops, including: geography and terrain, grouping and spacing of addresses, availability of suitable parking points, traffic patterns, safety, avoidance of retracing of other loops, establishment of extra parking points and shorter loops to minimize a carrier's total walking time, location of interspersed high-density dismount and curbside deliveries, and changes in the character of stops along the loop (such as new houses, apartments, or businesses, or the conversion of stops from single-delivery to multiple-delivery). See Tr. 18327-28. Each of these factors is unrelated to the average mail volume per delivery, but result in shorter loops with fewer stops. In sum, this "excess weight capacity is not deliberately designed into loops but is an incidental byproduct of other more important route structuring considerations." Id.

the second day. Tr. 18378-79, 18381. Her testimony disposes of Bradstreet's (and NAA's) claim that carrier park and loop costs are weight sensitive.<sup>18</sup>

**4. Elemental Load Costs Are Piece And Shape Related.**

NAA claims that McGrane's analysis "assumed that carrier street time costs do not vary by shape (Tr. 15/7778), and that elemental load costs are the same regardless of the weight of the piece. Tr. 15/7780," but that "no study" has been done. NAA Memo at 18. To begin with, both McGrane and Crowder did take into account the effect of shape in their analyses of ECR flat costs. Tr. 7779, 7708 (McGrane) and 18310-11 (Crowder). Second, as McGrane explained, there is no reason to believe that elemental load costs would be weight- rather than piece-related:

"I think it's a fairly obvious assumption to make. . . . [E]lemental load consists of the carrier reaching into the satchel and fingering the mail that he needs to deliver to that particular receptacle, lifting it out and placing in the receptacle. I don't see within the range of weight available in Standard A why weight should make a lot of difference to that procedure." Tr. 7780.

It is also noteworthy that Crowder appeared twice in this proceeding presenting extensive testimony on city delivery carrier load time cost issues, including specifically elemental load time costs and street time costs. JP-NOI-1, Tr. 16179-221; ADVO-RT-1, Tr. 18355-63. She also specifically stated that elemental load costs are shape-related. Tr. 18331. Her testimonies are the most extensive and thorough analyses of load time costs of any witness in this case. Yet NAA at no time asked her any questions about the supposed effects of weight on load time costs. Nor did NAA present any testimony or evidence of its own on these issues.

NAA, apparently, has chosen strategically to dance around this issue on the record, so that it can argue that "maybe" weight has some heretofore unproven effect. Then it can argue that "because we don't know for sure," the entire analyses presented

<sup>18</sup> Even assuming hypothetically that these costs were entirely weight-related (a completely unrealistic assumption), Crowder showed that the effect would be to add only 3.6¢ per pound (including Nelson's costs) to the costs in her cost curve. Tr. 18331.

by McGrane and Crowder should be “disregarded.” This, in fact, is the common thread throughout NAA’s arguments, employing speculation and nit-picks to cover the weakness of its case. What NAA hopes is that the Commission will overlook the cost effects identified on this record which clearly demonstrate that weight has a relatively minor effect on ECR costs.

What NAA overlooks is the huge disparity between the small identified effects of weight on costs and the high proposed pound rate. Even if some additional costs were to be identified as “weight-related,” that would not undermine the cost justification for the moderate reduction in the pound rate proposed by the Postal Service. No matter how much additional costs NAA might speculate to be somehow “weight-related,” NAA cannot possibly demonstrate or legitimately argue that the costs of ECR saturation mail above the breakpoint are *entirely* weight-related, as implied by the current rate structure -- or even *predominantly* weight-related, as implied by the proposed rate structure.

**F. Competitors’ Costs and Pricing Are Relatively Insensitive To Weight Compared To Saturation Mail -- A Disparity That Is Due To The Excessive Pound Rate.**

As witnesses Moeller, Buckel, Otuteye, and Crowder have pointed out, the current saturation rate above the breakpoint, which doubles as weight doubles, is illogical. In its memorandum, NAA alleges:

“This occurs only because the piece rate element for such [saturation] pieces is . . . zero. The Postal Service claims that such a rate pattern is inconsistent with private industry. NAA points out below that *no serious evidence concerning private sector pricing has been offered* to buttress this claim.” NAA Memo at 7, n. 12 (emphasis added).

NAA further claims that “[n]othing in the testimonies of Mr. Buckel or Mr. Otuteye provides any significant additional information” about pricing in other media. NAA Memo at 23.

NAA did not read the transcript. In his direct testimony, Buckel stated:

*"Unlike preprint insert rates of our non-postal competitors that increase only moderately as preprint weight increases, rates for mailed inserts must increase steeply with weight to cover the high linear pound rate postage cost. The Postal Service's proposed pound rate will moderate, but not eliminate, this disparity. For traditional retail preprints, such as a 2-or-more-ounce circular typical of the major retail preprints carried in newspapers, even the lower pound rate would still leave us priced out of the market."* Tr. 12091-92 (emphasis added).

Significantly, neither NAA nor AAPS cross-examined Buckel on his direct testimony. Nor did they file any rebuttal to his testimony. AAPS refused to provide information about pricing. Tr. 12037-38. NAA, by choosing not to present any newspaper industry witnesses in this case, foreclosed any opportunity for questions about newspaper pricing. Under these circumstances, NAA's claim that there is "no serious evidence" on competitors' pricing is preposterous. But there is even more.

On rebuttal, Buckel presented further evidence that proves the obvious -- that newspaper and alternate delivery pricing is far less sensitive to weight, and that this competitive disadvantage for mail is due to the unreasonably high pound rate:

"[A]lternate delivery generally has very little weight -- pricing sensitiv[ity] to weight." Tr. 17250.

"I am competing with a *newspaper hand delivery program that has virtually zero incremental costs* if they had that sheet, and it cost me to add that sheet, roughly \$5 or \$6 in postage, plus inserting, plus sales commission, handling costs, et cetera." Tr. 17260.

"In general in the alternate delivery industry rates tend to be weight-insensitive or have very little relationship to weight relative to the postal rates." Tr. 17274.

In response to questions from Commissioner LeBlanc, Buckel gave a specific "real-world example" illustrating this pricing disadvantage due to the pound rate. Tr. 17270-71, quoted above at page 10. Because of the high pound rate relative to newspapers' pricing structure, Buckel's publication lost a one-ounce piece from a large customer to a newspaper that offered a rate lower than his postage cost. "I couldn't have been competitive at that rate, because that didn't even cover postage." *Id.*

As Buckel explained, this “lower cost structure” of newspapers is not due to the USPS’s own cost structure, but rather to a high pound rate that fails to reflect costs. “I feel very strongly that the Post Office cost structure would allow an even lower level of pricing for my kind of mail.” Tr. 17276.

In light of Buckel’s “serious evidence concerning private sector pricing,” the only parties who can be accused of having presented “no serious evidence” on this issue are the competitors, NAA and AAPS.

**G. The Reduced Pound Rate Will Have A Positive Impact On USPS Finances.**

NAA asserts that “there is not a shred of evidence” that the lower pound rate “would improve USPS finances.” Claiming the “evidence points the other way,” it says that the ECR demand elasticity of less than one means that a rate reduction “would actually *reduce* the USPS’s net revenue,” and that if saturation mailers “merely add an additional insert to a mailing - making it heavier - that would produce no new volume for the Postal Service.” NAA Memo at 24. These assertions are wrong on every score. In fact, the positive financial impact is demonstrably greater than assumed by the Postal Service in its filing.

**1. Saturation Mail Is The Most Price Sensitive Component of ECR Subclass Volume.**

As to demand elasticity, saturation mail is more price sensitive and has a higher price elasticity than the ECR average. As the Commission found in Docket MC95-1:

“Based on the qualitative evidence, it appears that untargeted advertising mail *is more price sensitive* than targeted mail.” PRC Op. at V-186, ¶5451 (emphasis added).

“Alternative advertising media are closer natural substitutes for untargeted mail than for targeted mail. . . . *They compete directly with saturation and other high-density mail*, a large component of carrier route mail.” *Id.* at V-187, ¶5454 (emphasis added).

"Carrier route presort mail *contains a great deal of saturation mail, where mail costs are a higher proportion of the costs of doing business*, suggesting greater price sensitivity to the mail price than in non-carrier route presort mail. . . ." *Id.* at V-188, ¶5455, quoting Tolley (emphasis added).

"Carrier route mailers have higher own-price elasticities than noncarrier route mailers, *especially in the saturation categories.*" *Id.* at V-190, ¶5460 (emphasis added).

The testimonies of Buckel and Otuteye confirm this high price sensitivity of saturation mail<sup>19</sup> -- which should come as no surprise to NAA, since it is the intense competition between mailers and their newspaper and alternate delivery competitors that drives this price sensitivity.

## **2. New Incremental Revenues From Additional Weight.**

NAA's claims that "merely adding an additional insert" to a mailing would make it heavier but "would produce no new *volume* for the Postal Service." NAA Memo at 24 (emphasis added). This misses the point. Such added weight will produce new *revenue* for the Postal Service. As Buckel testified:

". . . I fully expect that our total postage bill will increase, probably significantly, if the USPS proposed rates were adopted. This is because the lower pound rate will enable us to generate new inserts that will pay additional incremental postage at the pound rate. For example, every extra one-tenth of an ounce in average weight added to our volume will produce new incremental postage in excess of \$100,000 annually." Tr. 12117.

Moreover, new pound-related revenue will be mostly new *net* revenue to the Postal Service, given the low marginal pound-related costs shown on this record.

## **3. New Piece Volumes.**

As to new piece volume generation, NAA's claim that the "record suggests" saturation mailers will merely add more weight rather than generate new mail

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<sup>19</sup> See, e.g., Tr. 12088-93, 17241-44 (Buckel) and 14501-04 (Otuteye).

(NAA Memo at 2) is wrong. Notably, its vague allusion to the “record” contains no *citations* to the record. But as Buckel testified:

“I know from discussions with others in the saturation mail industry that the high pound rate is an impediment not only to attracting insert volumes but to *expanding circulation in existing and new markets*. The ability to generate preprint inserts is often a critical ‘go or no-go’ factor in expanding or opening new markets.” Tr. 12092 (emphasis added).

The lower pound rate “will enhance our ability and desire to *expand geographically*, generating *new volumes* and postage.” Tr. 12117 (emphasis added).

Similarly, AISOP witness Otuteye testified that the current pound rate “makes it harder for Money Mailer and its franchisees to *expand our market coverage*,” and that the proposed pound rate will result in “our generating *more mail pieces* and pound rate volumes, and revenues, for the Postal Service.” Tr. 14508 (emphasis added). This will “allow new and existing franchisees to brave the risks of *expanding their business*,” and will “allow us to *open new territory* with our shared mail programs.” *Id.* (emphasis added).

Moreover, Buckel emphasized that the potential for new volume generation was by no means limited to existing mailers:

“I also believe that reduction of the pound rate to a more reasonable level *will encourage free community papers and shoppers and perhaps even newspaper TMC programs that are currently hand delivered to consider returning to the mail*.” Tr. 12092 (emphasis added).

Buckel elaborated on this point, explaining that the artificially high pound rate is what caused many of these former mailers -- including shoppers, free community newspapers, and even NAA members’ newspaper TMC programs -- to abandon postal delivery and switch to alternate delivery:

“Ironically, a number of shoppers and free community papers that use private delivery previously used the mail, but were driven away by increased postal rates. The 1987 postal rate increase, in particular, had a dramatic impact on the saturation mail business. That increase caused the diversion of many previously-mailed newspaper TMC programs and shoppers from the mail into private delivery, and rapid growth of private

delivery operations. Most if not all of the programs that shifted to private delivery were those with piece weights above the 3.3-ounce breakpoint, *where the high pound rate created an artificially high cost spread between mail and hand delivery.*" Id. (emphasis added).

This shift to alternate delivery due to the artificially-high postal rate structure was also described by Advo witness Kamerschen in Docket MC95-1 (Tr. 10159-62, quoting newspaper industry sources), and cited in Buckel's testimony. Tr. 17242-43.

**4. The Postal Service Has Understated The Positive Net Revenue Impact Of The Lower Pound Rate.**

Apart from all of the above factors, the Postal Service's own revenue analysis understates the positive impact of the lower pound rate. In developing its ECR test year revenue projections, the Postal Service made no adjustments to its base year billing determinants to account for new incremental weight or pound-rated revenues as a result of the lower pound rate. Employing "fixed weight" billing determinants, the Postal Service simply assumed that the proportion of piece-rated vs. pound-rated volume, and the average weight of pound-rated pieces, would remain unchanged under the proposed rates.

Yet clearly, the lower pound rate will generate both a higher proportion of pound-rated pieces (as new incremental weight shifts some pieces over the breakpoint), and a higher average weight and more total pounds of pound-rated mail. Both effects will generate greater pound-rated revenues than projected under the Postal Service's fixed-weight-index ECR revenue projections.

**H. The Only Criticism Of Moeller's "Guesstimate" ECR Pound Rate Is That He Guessed Too High.**

NAA criticizes Moeller's proposed ECR pound rate on the ground that "the 53 cent pound rate proposed by the Postal Service itself has no *particular* cost basis." NAA Memo at 26 (emphasis added). Noting that Moeller's specific rate was not derived directly as the mathematical output of a cost study, NAA claims the rate is merely the



result of his “playing around with a spreadsheet” and “plugging a guesstimate into the Commission’s formula.” *Id.*

NAA’s carefully couched claim -- that Moeller’s 53¢ pound rate “has no *particular* cost basis” -- is true only in the narrowest, most technical sense that the “particular” rate was not the direct mathematical output of a “particular” cost study number. NAA does not, and cannot, claim that the 53¢ rate has “*no* cost basis.” Moeller’s rate clearly has a compelling cost basis: the cost analyses on this record, as well as the other record evidence described in preceding sections of this brief, that convincingly demonstrate that ECR weight-related costs above the breakpoint are only a fraction of the proposed pound rate.

It is the current pound rate -- not Moeller’s proposed rate -- that has no cost basis. Although the current pound rate is the product of a “rate design formula,” that formula as applied in the past does not take into account the fact that a significant portion of costs above the breakpoint are piece-related, not pound-related. Moeller’s proposed rate structure specifically recognizes the existence of these piece-related costs, through his separate per-piece and per-pound rate elements. Moeller’s specific 3.2¢ per piece and 53¢ per pound rate elements (which NAA labels as “guesstimates”) are clearly more cost-based than the current rates, yet even they produce a steep rate structure out of line with the low weight-related costs shown on this record.

In sum, the only legitimate criticism of Moeller’s 53¢ pound rate “guesstimate” is that he guessed too high.

**V. THE OTHER ELEMENTS OF THE POSTAL SERVICE’S PROPOSED ECR RATE STRUCTURE ARE WELL SUPPORTED AND SHOULD BE ADOPTED.**

**A. The Proposed Letter/Flat Rate Differentials Are Sound And Cost Based.**

In Docket MC95-1, the Postal Service proposed no rate differential between ECR letters and flats, consistent with its automation operational objective to

encourage the shift of ECR letters into the DPS automation mailstream. This was also consistent with its transitional policy of barcoding and DPS-sequencing ECR letter mail in an effort to maximize DPS-processed volumes in order to achieve sufficient DPS density to convert carrier routes to the preferred Vertical Flat Case method of in-office carrier processing, rather than the composite bundle method that involves handling separate bundles of DPS and non-DPS letters. The Commission, citing cost differences between ECR letters and flats, instead recommended retaining letter/flat rate differentials.

In this case, the Postal Service has modified its MC95-1 proposal in a significant respect. Although it proposes to eliminate the rate differential between basic-level ECR letters and flats, it now proposes to maintain a letter/flat rate differential of 1.0¢ for high density mail and 0.7¢ for saturation mail.

The justification for elimination of the rate differential between basic-level letters and flats is stronger now than in MC95-1. Consistent with its automation objectives to DPS-process as much ECR letter mail volume as possible in order to achieve critical systemwide DPS densities, the Postal Service as a transitional measure takes significant volumes of nonautomation ECR letters out of the normal carrier route mailstream to be barcoded and run through DPS sorters. This extra processing adds handling costs for this volume, which could be more efficiently processed if presented as prebarcoded automation-rate mail.

For saturation and high density mail, the letter/flat rate differentials represent relatively high 80% and 60% passthroughs of the estimated cost differences, respectively. USPS-T-36 at 48 (revised 10/3/97). Moreover, as noted earlier, the letter/flat cost differences upon which these passthroughs are calculated represent *average* differentials between total letters and flats -- reflecting the cost effects of not just shape but weight. As USPS witness Moeller acknowledged, to the extent that a portion of the cost differential is related to weight (and hence is recovered through the

pound rate), the remaining shape-related cost differential would be correspondingly less than the average letter/flat difference used in his passthrough estimates. Consequently, the actual passthroughs of *shape-related* cost differences are undoubtedly higher than those estimated by Moeller. Tr. 3138-40.

**B. The Proposed ECR Saturation And High-Density Discounts Are Cost Based And Conservative.**

The Postal Service's proposed discounts for ECR high-density and saturation mail are based on a substantially improved cost analysis that recognizes not only delivery but mail processing cost differences among density-related rate categories. In the past, these significant mail processing cost differences have been overlooked. The Postal Service's approach is an improvement in tracing costs to underlying mail characteristics.

NAA witness Donlan argued that the Postal Service's proposed high-density and saturation discounts should be rejected, and that the discounts remain unchanged from their current levels. His criticisms are unfounded, and do not in any manner undermine the cost bases for the proposed discounts.

Donlan's criticisms focused on the mail processing component of the Postal Service's estimated cost differences. His main argument was that the Postal Service used FY1996 cost data to estimate the mail processing cost differences, which he claimed do not reflect the post-reclassification operating environment and cost differences. He provided a breakout of FY96 data into pre- and post-reclassification time periods. From this breakout, he calculated that the unit mail processing cost differential between walk-sequenced and non-walk-sequenced mail declined from 2.164¢ to 1.465¢ after reclassification.

What Donlan did not mention is that the separate unit costs for both non-walk-sequenced and walk-sequenced mail also declined. As Crowder pointed out, these post-reclassification cost reductions are not reflected in the Postal Service's test year

ECR costs. Consequently, if the reduced cost differential is to be recognized for purposes of the discount, then the reduced unit costs must likewise be reflected in the ECR test year costs, reducing TYBR ECR non-letter costs by \$71.5 million. Tr. 18333-36.

Moreover, Crowder showed that even if Donlan's reduced mail processing cost differential were adopted, the Postal Service's discount proposals would still be fully cost justified. What Donlan overlooked is that the Postal Service's proposed passthroughs for nonletters are so low that, even after Donlan's reclassification cost adjustment, the discounts would still be substantially less than the cost differences. In fact, the discounts are less than the cost differential for the delivery cost component alone, without considering the mail processing cost difference. Donlan's proposal to freeze the nonletter discount is therefore baseless.

In the case of ECR letters, Donlan made a different argument, claiming that the Postal Service did not recognize ECR letter delivery cost savings, and that their cost estimates overstate the actual cost difference between walk-sequenced and non-walk-sequenced mail, causing the proposed ECR basic letter costs and rates to be too high. As Crowder explained, Donlan is wrong here as well. There were substantial volumes of both automated and non-automated ECR letters that were DPS-processed in the base year. Automation-related delivery cost savings for letter mail were therefore reflected in the base year delivery costs. Tr. 18340-41. By starting with delivery costs that reflect those savings, USPS witness Hume's analysis implicitly included those savings in his calculation of ECR letter delivery costs. Tr. 18398-401. Donlan further ignored that Hume separately calculated additional DPS-related delivery costs savings for automation ECR letters that are included in his letter cost estimates. Tr. 18342.

The Postal Service's proposed passthroughs for the letter density discounts are also reasonable. They translate into cost differential passthroughs very near 100 percent, consistent with the Postal Service's automation objective to encourage

conversion of ECR basic-rate letters to the Automation 5-Digit and Automation Carrier Route categories. Tr. 18343-44.

In sum, Donlan's proposals to modify the Postal Service's proposed density discounts for letter and nonletter ECR saturation and high-density mail should be rejected.

### CONCLUSION

For the above reasons, the Saturation Mail Coalition urges the Commission to recommend to the Governors adoption of the classifications and rates proposed by the Postal Service in this proceeding.

Respectfully submitted,



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### CERTIFICATE OF SERVICE

I hereby certify that I have on this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



Thomas W. McLaughlin

April 1, 1998